IN THE
SUPREME COURT OF MISSOURI

No. SC84168

SOUTHWESTERN BELL YELLOW PAGES, INC.
Respondent,
v.
DIRECTOR OF REVENUE,
Appellant.

Petition For Review
From The Administrative Hearing Commission,
The Honorable Karen Winn, Commissioner

Respondent's Brief

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Statement of Facts

This case was tried on a Joint Stipulation of Facts, which were either quoted or paraphrased by the Administrative Hearing Commission in its Findings of Fact. See Appendix A-1 (Findings of Fact and Conclusions of Law) and Appendix A-2 (Joint Stipulation of Facts).

Southwestern Bell purchased rolls of raw paper stock and manufactured the raw paper into yellow page directories. All of this activity occurred outside the State of Missouri. Southwestern Bell then distributed the yellow page directories free of charge to Missouri residents.

The State could not impose a sales tax directly on the yellow page directories because Southwestern Bell did not sell the directories – there was no sales price or taxable consideration for the free directories. Instead, the State attempted to tax the company indirectly by taxing Southwestern Bell on the purchase of the raw paper in other states and by taxing Southwestern Bell on the charges for printing that occurred in other states.

Prior to the Administrative hearing, the Director of Revenue agreed that no sales or use tax was due on the printing charges. The only remaining issue is whether Missouri use tax was due on the purchase of the raw paper in other states. The Administrative Hearing Commission concluded that no use tax was due because no taxable event occurred within the State of Missouri.

Reply Point

The raw paper stock consumed in printing the telephone directories was not used in Missouri, and therefore no Missouri use tax was due.

Argument

A. Summary.

The decision of the Administrative Hearing Commission should be affirmed because it follows the precedent established by this court in *International Business Machines Corp. v. David*, 408 S.W.2d 833 (Mo. 1966) (Appendix A-3) and the precedent established by the Missouri Administrative Hearing Commission in *Morton Buildings, Inc. v. Director of Revenue*, Case No. 88-001879RZ (1989) (Appendix A-4): raw materials that are manufactured into other items outside the State of Missouri are not used in Missouri, and thus are not subject to the Missouri use tax, regardless of whether tax was paid on the raw material in the state of origin. In this case, the rolls of blank paper stock were manufactured into yellow page telephone books outside the State of Missouri, and because the rolls of blank paper stock were not used in Missouri, no Missouri use tax was due.

B. The Missouri use tax.

The Missouri use tax is imposed "for the privilege of storing, using or consuming within this state any article of tangible personal property." Mo. Rev. Stat. § 144.610. The statute further provides that the tax does not apply "with respect to the storage, use or consumption of any article of tangible personal property purchased, produced or manufactured outside this state until the transportation of the article has finally come to rest within this state or until the article has become commingled with the general mass of property of this state." *Id*.

C. *IBM*.

The Missouri Supreme Court interpreted this use tax provision in *International Business Machines Corp. v. David*, 408 S.W.2d 833 (Mo. 1966). IBM contended that the Missouri use tax was not applicable to the component parts used to make its business machines outside of the state, even

though the fully assembled machines were ultimately used in the state. The Missouri Supreme Court agreed, stating:

> [O]ur use tax applies to the completed article (machine here) that is brought into this state and not the items of raw material that went into its manufacture, which, of course, are greatly changed in form and could not be identified as separate articles. . . . Likewise, because the raw material used to make these machines was never used in this state as such, it seems reasonable to hold there is no basis for a use tax on its value because it is part of a machine which is the article used in this state.

Id. at 836.

The Appellant contends that "*IBM* does not support Bell's refund" because, "[u]nlike the raw materials with little value that were used by the taxpayer in *IBM* to make machines with a substantial (taxable) rental value, the paper purchased by Bell was not substantially changed in form and comprised nearly half of the value of the free yellow page telephone directories." Appellant's Brief at 14.

With regard to Appellant's reference to "raw materials with little value," the *IBM* opinion mentioned that the value of the raw materials was less than the value of the completed machine, and therefore taxing the raw materials might not be a fair substitute for taxing the rental of the completed machine. However, the opinion concluded that "we do not need to decide whether such differences would justify separate classification..." IBM, 408 S.W.2d at 835-836. Therefore, the relative value of the raw materials to the labor cannot be a basis for distinguishing the *IBM* case. Furthermore, the Court should not adopt a "little value" standard, because such a standard would be virtually impossible to administer.

With regard to the Appellant's distinction based on change in form, the *IBM* opinion noted that that the machines were "greatly changed in form and could not be identified as separate articles." IBM, 408 S.W.2d at 836. If the assembled components of IBM's computers were "greatly changed in form and could not be identified as separate articles," surely the rolls of raw paper stock, which were cut, printed, and bound into yellow page directories were also "greatly changed in form and could not be identified as separate articles."

The Appellant's observation that IBM paid tax on the rental of its machines (Appellant's Brief at 14) provides no basis for distinguishing the cases. If Southwestern Bell had rented or sold its directories, it would have had the same obligation to collect and remit sales tax that IBM had. The fact of the matter was that Southwestern Bell gave away its yellow page directories because its main source of revenue was advertising. The Missouri Legislature could have taxed advertising sales if it had wanted to, but it chose not to do so. Mo. Rev. Stat. § 144.034; see former 12 Code of State Regulations 10-3.590 (rescinded November 30, 2000) .

The Appellant further asserts: "By inserting the word 'completed' in front of the word 'article' in this sentence [of section 144.610.1], the [*IBM*] Court renders meaningless the statutory terms 'produced' and 'manufactured' that follow." Appellants Brief at 17. The Appellant's criticism is invalid. The *IBM* opinion does not render meaningless the terms "produced" and "manufactured." The opinion simply holds that any article, whether raw or completed, and whether purchased, produced, or manufactured, is not subject to the use tax if it "was never used in this state as such." IBM, 408 S.W.2d at 836. Because the computer components could not be identified as "separate articles," they were not subject to the use tax. *Id*. Similarly, because the rolls of raw paper stock could not be identified as separate articles from the yellow page directories, no use tax was due.

D. *Morton Buildings*.

Morton Buildings, Inc. v. Director of Revenue, Administrative Hearing Commission Case 88-001879RZ (1989) is directly on point. The taxpayer manufactured, sold, and installed prefabricated utility buildings. The raw materials used in the buildings were purchased and manufactured into component parts outside the State of Missouri.[1] The buildings were then assembled from the component parts in Missouri. The Commission determined that no use tax was due on the raw materials or the component parts and ordered a refund for the taxpayer. The Commission held that "Morton Buildings is not liable for use tax on its raw materials used to manufacture the building components because the manufacturing process changes them to the extent that they cannot be identified as 'articles' to which the use tax applies." *Id*.

The *Morton Buildings* opinion contains no discussion whatsoever concerning the relative value of the raw materials to the labor, so that factual distinction, which the Appellant wrongly alleges to exist in the *IBM* case, does not exist. The *Morton Buildings* opinion does discuss the change in form that occurred, and concluded that "[a]lthough the lumber, steel sheeting, nails and other raw materials that go into the building components manufactured by Morton Buildings outside Missouri may be suitable for common use before they are made a part of the building components, these raw materials nevertheless lose their individual identities and become part of a manufactured product." *Id*. These

[1] It may be inferred that Morton Buildings did not pay sales or use tax to other states on all of these purchases. If it had, it would have been able to offset its Missouri use tax liability with the Missouri tax credit for tax paid to other states, and there would have been no dispute. See 12 Code of State Regulations 10-4.100.

facts are not distinguishable from the Respondent's case – the rolls of paper stock were raw materials that lost their identities when they were cut, printed, and bound into manufactured yellow page directories, just as the lumber, steel sheeting, nails were raw materials that lost their identities when Morton Buildings assembled them into building components.

E. Conclusion.

The Court should follow its own precedent established by the *IBM* case. The raw paper stock was never used as such in Missouri, and thus was not subject to the Missouri use tax. The Court cannot be swayed by whether or not Southwestern Bell paid sales tax on the raw materials in any other jurisdiction. That issue is a matter between Southwestern Bell and the other jurisdictions. The sole question is whether Southwestern Bell made a taxable use of the raw materials as such in the State of Missouri. The company did not use the raw materials in Missouri, so the State has no right to tax the paper based on its purchase price in the states where the paper was purchased. Therefore, the decision of the Administrative Hearing Commission should be affirmed.

Respectfully submitted,

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Certification of Service and of Compliance with Rule 84.06(b) and (c)

The undersigned hereby certifies that on this April 29, 2002, one true and correct copy of the foregoing brief, and one disk containing the foregoing brief, were mailed, postage prepaid, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains 2,034 words.

The undersigned further certifies that the labeled disk, simultaneously filed with the hard copies of the brief, has been scanned for viruses and is virus-free.

[Signed]
Ray Langenberg

Appendix A-1
Administrative Hearing Commission
State of Missouri

***1** SOUTHWESTERN BELL YELLOW PAGES, INC., PETITIONER
v.
DIRECTOR OF REVENUE, RESPONDENT
No. 2000-1500 RV
November 29, 2001

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On May 19, 2000, Southwestern Bell Yellow Pages, Inc. (Southwestern Bell) filed a complaint appealing the Director of Revenue's decision to deny its refund claim for use tax on raw materials and printing charges used to manufacture yellow page telephone directories. Mark W. Eidman and Ray Langenberg, with Scott, Douglass & McConnico, L.L.P., and Gary Hartman, with Southwestern Bell, represented Southwestern Bell. Associate Counsel Roger L. Freudenberg represented the Director.

On July 16, 2001, the parties filed a joint stipulation of facts. The matter became ready for our decision on October 1, 2001, when Southwestern Bell filed the last brief.

Findings of Fact

1. Southwestern Bell is a corporation authorized to do business in Missouri, with its principal Missouri business office located at 1 Bell Center, Suite 3600, St. Louis, MO 63101.

2. Southwestern Bell publishes and distributes yellow page telephone directories (directories) for residential and business use in areas of the state where telephone service is provided by Southwestern Bell Telephone Company. There is no charge for the directories.

3. Missouri businesses pay to advertise in the directories. This is the main source of revenue from the publication and distribution of the directories.

4. Southwestern Bell purchased rolls of blank paper stock from various paper mills located outside of Missouri for delivery to a printer located outside of Missouri.

5. Southwestern Bell contracted with the printer to cut, print and bind the paper into the directories.

6. The printer shipped the directories to a Missouri independent contractor, employed by and under the direction of Southwestern Bell, to distribute the directories.

7. Southwestern Bell self-assessed and paid Missouri use tax on the purchases of paper and printer charges for the directories distributed in Missouri.

8. Other than the use tax paid to Missouri, Southwestern Bell did not pay any state or local sales or use tax on the paper purchased or the printer charges for the Missouri directories.

9. On December 20, 1999, Southwestern Bell filed an application for tax refund/credit. On March 21, 2000, the Director denied the application.

Conclusions of law

This Commission has jurisdiction over appeals from the Director's final decisions. Section 621.050.1. [FN1] Southwestern Bell has the burden to prove that it is entitled to a refund. Section 621.050.2. Our duty in a tax case is not merely to review the Director's decision, but to find the facts and to determine, by the application of existing law to those facts, the taxpayer's lawful tax liability for the period or transaction at issue. J.C. Nichols Co. v. Director of Revenue, 796 S.W.2d 16, 20-21 (Mo. banc 1990).

The parties agree that Southwestern Bell is owed a refund of $1,012,449.23 for Missouri use taxes paid on printing charges, plus statutory interest. [FN2] Because the parties have removed this issue from us without explanation, we will only consider liability for tax on the paper used.

***2** Section 144.610 states:

> 1. A tax is imposed for the privilege of storing, using or consuming within this state any article of tangible personal property .... This tax does not apply with respect to the storage, use or consumption of any article of tangible personal property purchased, produced or manufactured outside this state until the transportation of the article has finally come to rest within this state or until the article has become commingled with the general mass of property of this state.

Southwestern Bell argues that it does not owe use tax because the paper, which was purchased in another state, was consumed and transformed into the directories. Thus, the paper was never used in Missouri. The Director argues that Southwestern Bell used the paper in Missouri because paper makes up a substantial portion of a directory and a substantial portion of the value of a directory.

Both parties cite International Business Machines Corp. v. David, 408 S.W.2d 833 (Mo. banc 1966). In that case, the court found that the Director could not tax parts used to manufacture machines because the manufacture took place in another state. The court stated:

> From all of these provisions, our view is that our use tax applies to the completed article (machine here) that is brought into this state and not the items of raw material that went into its manufacture, which, of course, are greatly changed in form and could not be identified as separate articles. Because the machines involved herein were not purchased by plaintiff, but manufactured by it, they are not subject to our use

> tax. Likewise, because the raw material used to make these machines was never used in this state as such, it seems reasonable to hold there is no basis for a use tax on its value because it is part of a machine which is the article used in this state.

Id. at 836. The Director argues that, although the paper was purchased, printed, and bound outside of Missouri, Southwestern Bell used the paper to fulfill its advertising obligations. She argues that the paper did not substantially change its form as did the component parts of the machines in IBM.

Southwestern Bell characterizes the paper as raw material that, like the component parts, has changed into a new tangible personal property. We agree. In the same way that the machine parts were assembled into a machine, the rolls of paper were used to manufacture the telephone books. This reading is also consistent with our decision in Morton Buildings, Inc. v. Director of Revenue, No. 88-001879 RZ, (Admin. Hearing Comm'n Dec. 8, 1989), in which this Commission found that no use tax was due on raw materials used to manufacture building components. We stated:

> Although the lumber, steel sheeting, nails and other raw materials that go into the building components manufactured by Morton Buildings outside Missouri may be suitable for common use before they are made a part of the building components, these raw materials nevertheless lose their individual identities and become part of a manufactured product.

***3** Id. at 8. In American Watchmakers - Clockmakers Inst. v. Tracy, 742 N.E.2d 228 (Ohio App. 2000), the court found that a tax exemption should be granted because items purchased by a publisher were consumed in the publication process. In the same way, the raw paper is consumed when it is processed into a directory.

If Southwestern Bell had bought the paper in Missouri, or from a state that charged sales tax, then it presumably would have paid tax on the purchase of the paper. The Director argues that if we accept Southwestern Bell's argument, companies who purchase supplies outside the state would be treated more favorably under the law than companies who purchase supplies within the state. It is true that under the facts of this case Southwestern Bell has paid no tax to any state for the purchase of the paper. However, this fact cannot change our decision.

The Director also relies on Montgomery Ward Co. v. Director of Revenue, No. RS-84-0375 (Admin. Hearing Comm'n July 22, 1987), a case in which this Commission upheld the Director's assessment of use tax on the retailer's catalogues because they "came to rest" in the state when deposited in Missouri mailboxes. However, the Montgomery Ward case did not ask us to address the "raw material" argument put forth by Southwestern Bell in this case. And the Director does not argue that the distribution of the Yellow Pages themselves is subject to use tax. [FN3]

We agree that the purpose of the use tax statute is "to protect Missouri revenue and Missouri sellers against competition from out-of-state sellers by removing any advantage which might be gained by making purchases outside the state, on which no sales tax is collected." R & M Enterprises v. Director

of Revenue, 748 S.W.2d 171, 172 (Mo. banc 1988). We acknowledge that our determination does not aid that purpose in this unusual case in which the end product is not "sold" to a purchaser, but distributed free of charge. However, we believe that IBM and May Dep't Stores, read together, allow Southwestern Bell to avoid the incidence of use tax on its yellow pages in Missouri.

Summary

Southwestern Bell does not owe use tax on its purchase of raw paper purchased outside of Missouri because the paper was processed into telephone directories. Southwestern Bell is owed a refund of $860,832.19, plus statutory interest.

SO ORDERED on November 29, 2001.

Karen A. Winn

Commissioner

FN1. Statutory references, unless otherwise noted, are to the 2000 Revised Statutes of Missouri.

FN2. Jt. Stip. ¶ 13, filed July 16, 2001.

FN3. It appears that the Director's ability to assess use tax on the distribution of catalogues and perhaps yellow pages is governed by May Dep't Stores Co. v. Director of Revenue, 748 S.W.2d 174 (Mo. banc 1988), which decided that the price a department store paid for catalogs printed out of state and mailed directly to customers was not subject to use tax. (May also casts doubt on our holding in Montgomery Ward.) This is in contrast to other states that have taxed this type of transaction based on the fact that the party is "using" the catalog by distributing it. See Revenue Cabinet v. Lazarus, 49 S.W.3d 172 (Ky. 2001); J.C. Penney Co. v. Balka, 577 N.W.2d 283 (Neb. 1998); Service Merchandise Co. v. Arizona Dep't of Revenue, (Ariz. App. 1996). The United States Supreme Court has found that this type of taxation does not violate the Commerce Clause. D.H. Holmes Co. v. McNamara, 505 So.2d 102, 105 (La. App. 1987), aff'd, 486 U.S. 24 (1988). The court in Adco Publishing v. Commissioner of Revenue, 1996 WL 585157 (Minn. Tax), assessed use tax to the purchase price of telephone directories. There may be an even more compelling argument to support assessing directories than catalogs, because the business entity has sold advertisements to third parties and is using the directories (if not the paper) to fulfill this obligation.

2001 WL 1579573 (Mo.Admin.Hrg.Com.)

END OF DOCUMENT

Appendix A-2

BEFORE THE
ADMINISTRATIVE HEARING COMMISSION
STATE OF MISSOURI

SOUTHWESTERN BELL YELLOW PAGES, INC.	)	
	)	
Petitioner,	)	
	)	
v.	)	Case No. 00-1500 RV
	)	
DIRECTOR OF REVENUE,	)	
STATE OF MISSOURI,	)	
	)	
Respondent.	)	

JOINT STIPULATION OF FACTS

COMES NOW Petitioner, Southwestern Bell Yellow Pages, Inc., and Respondent, Director of Revenue, by and through counsel, and stipulate for the purpose of this case that the following facts shall be considered correct and conclusive and the Exhibits hereinafter mentioned shall be admitted in evidence and considered authentic. Each party retains the rights (1) to introduce other and further evidence not inconsistent herewith, and (2) to object to the facts and Exhibits stipulated herein on the grounds of materiality or relevance, but each party waives all other evidentiary objections to the facts and Exhibits stipulated herein.

1. Southwestern Bell Yellow Pages, Inc. (hereinafter referred to as "Southwestern Bell"), the Petitioner herein, is a corporation authorized to do business in the State of Missouri with its principal Missouri business office located at 1 Bell Center, Suite 3600, St. Louis, Missouri 63101.

2. The Director of Revenue of the State of Missouri (hereinafter referred to as "Director"), the Respondent herein, is the duly appointed and qualified Director of the Missouri Department of Revenue.

3. Southwestern Bell's Missouri business is the publication and distribution of yellow page telephone directories for residential and business use in areas of the state where telephone service is provided by the Southwestern Bell Telephone Company. There is no charge to receive a yellow page

telephone directory.

4. Southwestern Bell's main source of revenue from the publication and distribution of yellow page telephone directories in Missouri is from amounts paid by Missouri businesses to advertise in Southwestern Bell's yellow page telephone directories.

5. Southwestern Bell purchased rolls of blank paper stock from various paper mills located outside of Missouri for delivery to a printer located outside of Missouri. Other than the use tax paid to the State of Missouri, Southwestern Bell did not pay any state or local sales or use tax of any state on the paper purchased for the Missouri yellow page telephone directories.

6. Southwestern Bell contracted with the printer to cut, print and bind the paper into yellow page telephone directories. Other than the use tax paid to the State of Missouri, Southwestern Bell did not pay any state or local sales or use tax of any state on the printer charges for the Missouri yellow page telephone directories.

7. The printer shipped Southwestern Bell's yellow page telephone directories to a Missouri independent contractor, employed by and under the direction of Southwestern Bell, to distribute the yellow page telephone directories in Missouri.

8. Southwestern Bell self-assessed and paid Missouri use tax on its purchases of paper and printer charges for yellow page telephone directories distributed in Missouri.

9. Southwestern Bell filed an Application For Tax Refund/Credit with the Respondent on December 20, 1999. A true and correct copy is attached as Exhibit A, which is incorporated into and made part of this Stipulation of Facts.

10. The Director denied Southwestern Bell's Application For Tax Refund/Credit by Final Decision on March 21, 2000. A true and correct copy is attached as Exhibit B, which is incorporated into and made part of this Stipulation of Facts.

11. Southwestern Bell filed its Complaint with the Administrative Hearing Commission on May 19, 2000.

12. The Director filed her Answer with the Administrative Hearing Commission on July 10, 2000.

13. The Director and Southwestern Bell agree that a refund in the amount of $1,012,449.23 for Missouri use taxes paid on printing charges, plus statutory interest, should be granted.

14. The Director and Southwestern Bell disagree that a refund in the amount of $860,832.19 for Missouri use taxes paid on paper purchases, plus statutory interest, should be granted. The parties agree on the amount of tax at issue.

WHEREFORE, the parties respectfully request the Commission set a briefing schedule in this matter and decide this case without an evidentiary hearing as provided in 1 CSR 15-3.450.

Respectfully submitted,

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Appendix A-3

408 S.W.2d 833.
(Cite as: 408 S.W.2d 833)

INTERNATIONAL BUSINESS MACHINES CORPORATION, a Corporation, Appellant,

v.

Thomas A. DAVID, Director of Revenue, State of Missouri, and Albert S. Arenson, Collector of Revenue, Respondents.

No. 51918.

Supreme Court of Missouri, En Banc.

Nov. 14, 1966.

Rehearing Denied Dec. 12, 1966.

Declaratory judgment action brought by business machine manufacturer against Department of Revenue to determine the constitutional validity of statute imposing sales tax upon all sellers engaged in business of renting tangible personal property at retail. The Circuit Court of Cole County, Sam C. Blair, J., rendered judgment for the Department of Revenue and the manufacturer appealed. The Supreme Court, Hyde, J., held that where machines manufactured by business machine manufacturer outside of state and brought into state for sale or rental were not subject to use tax, manufacturer's rental of its machines was not within statutory exemption from sales tax on rental receipts provided when lessor had paid sales or use tax on tangible property at time of its purchase.

Affirmed.

[1] PLEADING k350(1)
302k350(1)
Where plaintiff's petition, sales and rental agreements and rule and a regulation of State Department of Revenue attached to petition as exhibits and admissions contained in Department of Revenue's answer comprised entire record before trial court on plaintiff's motion for summary judgment in declaratory judgment action contesting validity of tax act, motion would be treated as one for judgment on the pleadings. Section 144.020, subd. 1(8) RSMo 1965 Supp., V.A.M.S.

[2] TAXATION k1245
371k1245
Formerly 238k15.1(10)
Use tax is applicable to completed article that is brought into state and not on items of raw material that

went into article's manufacture. Section 144.020, subd. 1(8) RSMo 1965 Supp., V.A.M.S.

[3] TAXATION k1233
371k1233
Formerly 238k15.1(6)
Business machine manufacturer was not liable for use tax upon business machines which it manufactured outside of state rather than purchased and brought into state for rental to its customers. Section 144.020, subd. 1(8) RSMo 1965 Supp., V.A.M.S.

[4] TAXATION k1245
371k1245
Formerly 238k15.1(10)
There is no use tax on value of raw material used in manufacture of machine brought into state by its manufacturer. Section 144.020, subd. 1(8) RSMo 1965 Supp., V.A.M.S.

[5] TAXATION k1236
371k1236
Formerly 238k19(3)
Where machines manufactured by business machine manufacturer outside of state and brought into state for sale or rental were not subject to use tax, manufacturer's rental of its machines was not within statutory exemption from sales tax on rental receipts provided when lessor had paid sales or use tax on tangible property at time of its purchase. Section 144.020, subd. 1(8) RSMo 1965 Supp., V.A.M.S.

[6] TAXATION k1213
371k1213
Formerly 238k7(2)
Where business machine manufacturer was not liable for use tax on machines it manufactured outside of state and brought into state to rent to customers, statute exempting tangible personal property on which sales or use tax had been paid at time of purchase from 3% tax on rental charge when property is rented did not discriminate against manufacturer. Section 144.020, subd. 1(8) RSMo 1965 Supp., V.A.M.S.

[7] STATUTES k121(1)
361k121(1)
Sales Tax Act, entitled "An Act to repeal section 144.020, RSMo 1959, and sections 144.140, 144.285, 144.440, RSMo 1961 Supp., relating to sales and use tax and to enact in lieu thereof five new sections, relating to the same subject, with a severability clause.", did not violate constitutional requirement that subject of Act shall be clearly expressed in its title. Section 144.020 and subd. 1(8) RSMo 1965 Supp., V.A.M.S.; V.A.M.S.Const. art. 3, § 23; art. 10, §§ 1, 2.
***834** Walter R. Mayne, N. W. Hartman, Thomas Rowe Schwartz, Fordyce, Mayne, Hartman, Renard & Stribling, St. Louis, for appellant.

Norman H. Anderson, Atty. Gen., Walter W. Nowotny, Jr., Asst. Atty. Gen., Jefferson City, for respondents.

HYDE, Judge.

Declaratory judgment action to determine the constitutional validity of Sec. 144.020, subd. 1(8) and its applicability to plaintiff's rental transactions. The case was decided on plaintiff's motion for summary judgment or judgment on the pleadings. (Statutory references are to RSMo and V.A.M.S.) The Court entered judgment for defendants, declaring Sec. 144.020, subd. 1(8) constitutional and that it 'validly imposes a tax upon all sellers for the privilege of engaging in the business of rendering taxable rental service at retail.' Plaintiff has appealed.

[1] There was nothing before the trial court except the plaintiff's petition, the exhibits attached to plaintiff's petition (sales and rental agreements and a rule and a regulation of the Department of Revenue) and the admissions in defendants' answer of the relevant facts. Therefore, we will consider the submission as one for judgment on the pleadings.

Sec. 144.020, subd. 1(8) is as follows: 'A tax equivalent to three per cent of the amount paid or charged for rental or lease of tangible personal property, provided that if the lessor or rentor of any tangible personal property had previously purchased the property under the conditions of 'sale at retail' as defined in subdivision (8) of section 144.010 and the tax was paid at the time of purchase, the lessor or rentor shall not apply or collect the tax on the subsequent lease or rental receipts from that property; and provided, further, that the purchase or use of motor vehicles and trailers shall be taxed and the tax paid as provided in sections 144.070 and 144.440 and no such tax shall then be collected on the rental or lease of motor vehicles and trailers; and provided, further, that tangible personal property which is exempt from the sales or use tax under section 144.030 upon a sale thereof is likewise exempt from the sales or use tax upon the lease or rental thereof.' (Emphasis ours.)

Plaintiff claims the italicized provision makes this statute unconstitutional. Plaintiff is a New York corporation authorized to do business in Missouri. It sells business machines in Missouri and collects and pays sales tax on such sales to the Missouri Department of Revenue. There is no ***835** dispute about a tax on these transactions. Plaintiff also rents business machines in Missouri and the right of this state to collect sales tax on the rentals received for these machines is the issue in this case. The tax on these rentals is being collected from customers and paid under protest. Any refund would be returned to plaintiff's customers. All machines, sold or rented, are manufactured by plaintiff outside of this state and all machines sold or rented in this state are shipped into Missouri prior to their sale or lease. Plaintiff claims its only tax liability to this state on the machines it rents here should be for our use tax on the materials used to make these machines. The State contends Sec. 144.020, subd. 1(8) properly classifies the rental of these machines as a taxable sale of service.

Plaintiff argues that the purpose of Sec. 144.020, subd. 1(8) is to reach rentals of tangible personal property, where the rentor had not been subject to sales or use tax on the acquisition of such property, but it says that plaintiff is subject to the use tax on this tangible personal property brought into this state for its rental business. (Plaintiff means use tax on the value of the material used by it to make these machines and not on the value of completed machines.) Therefore, plaintiff says the denial to it of the right to avail itself

of the opportunity to avoid rental tax under the first proviso of Sec. 144.020, subd. 1(8) is arbitrary discrimination against it and its customers. Otherwise stated plaintiff claims if the owner of a machine who has purchased it, and paid sales tax or use tax on its purchase price at the time of purchase, is made exempt from sales tax on rentals he receives then an owner who has manufactured a machine and has to pay a use tax on the materials that went into it (because the materials were bought in another state) must also be made exempt on the rentals he receives. Plaintiff claims it arbitrary discrimination to do otherwise. Plaintiff says: 'Defendants have no power by Regulation and Rule to classify lessors into two different groups: (1) those who purchase goods requiring no further steps prior to being rented, and (2) those who purchase goods requiring further processing before being rented. There is no basis in the Sales and Use Tax Laws for such classification or provision for exemption from sales or use tax to one such group and not the other.'

Defendants' position is that plaintiff was not required to pay use tax on its machines brought into this state for rental or on the material used to make them. Defendants say: 'The finished product is what is introduced into Missouri and imposition of the use tax depends on whether that finished product was purchased outside Missouri and used in Missouri by the purchaser. Thus before the enactment of subdivision 8 IBM and persons like IBM, who manufactured machines and leased them in Missouri, would not be liable for a use tax on that machine.' If defendants are correct and plaintiff has no use tax liability on the machines it manufactures elsewhere and brings into this state to rent, then there is no basis for its claim of discrimination.

Plaintiff cites no specific provision of our statutes which imposes liability for use tax on material bought in another state to manufacture a machine that is brought into this state by the manufacturer for his own use or to be rented by him and we have found none. The value of such material would surely be a small part of the value of the machine, the cost of which also would include labor cost, know-how and reasonable profit. Thus the amount of tax on the materials would be small compared to the tax on the completed machine, so that rentals would have some relation to the value of the completed machine but almost none as to the value of the raw material of which it was composed. For reasons hereinafter stated, we do not need to decide whether such differences would justify separate classification but we do think ***836** these facts have some bearing on the determination of the applicability of our use tax.

[2][3][4][5][6] Our use tax is imposed by Sec. 144.610 'for the privilege of storing, using or consuming within this state any article of tangible personal property purchased on or after the effective date' of the use tax act. Furthermore, '(t)his tax does not apply with respect to the storage, use or consumption of any article of tangible personal property purchased, produced or manufactured outside of this state until the transportation of the article has finally come to rest within this state or until the article has become commingled with the general mass of property of this state.' (Emphasis ours.) Exempt from our use tax by Sec. 144.615(3) is: 'Tangible personal property, the sale of which, if made in this state, would be exempt from or not subject to the Missouri sales tax under the provisions of subsections 2 and 3 of section 144.030'. These subsections include materials, replacement parts and equipment for replacing other equipment used in manufacturing. Also exempt from our use tax by Sec. 144.615(5) is: 'Tangible personal property which has been subjected to a tax by any other state in this respect to its sales or use,' providing for collection of the difference if the tax is less than ours. In Southwestern Bell Telephone Company v. Morris, Mo.Sup., 345 S.W.2d 62, 66, 85 A.L.R.2d 1033, we approved the characterization of a use tax as '"* * * a levy on the privilege of using within the taxing state property purchased outside the state, if the

property would have been subject to the sales tax had it been purchased at home." From all of these provisions, our view is that our use tax applies to the completed article (machine here) that is brought into this state and not the items of raw material that went into its manufacture, which, of course, are greatly changed in form and could not be identified as separate articles. Because the machines involved herein were not purchased by plaintiff, but manufactured by it, they are not subject to our use tax. Likewise, because the raw material used to make these machines was never used in this state as such, it seems reasonable to hold there is no basis for a use tax on its value because it is part of a machine which is the article used in this state. Our conclusion is that defendants are correct as to this alleged use tax liability. Of course, if plaintiff does not have use tax liability it claims it has, there is no discrimination and we so hold.

Plaintiff further contends that a valid tax on its rentals could be enacted only by amending Sec. 144.010, subd. 1(8) to include rentals of tangible personal property, made taxable by Sec. 144.020, subd. 1(8), in its definition of sale at retail, citing International Business Machines Corporation v. State Tax Commission, Mo.Sup., 362 S.W.2d 635, and Federhofer v. Morris, Mo.Sup., 364 S.W.2d 524. Plaintiff says in those cases we pointed out to the Legislature this simple method of subjecting such rental transactions to tax. Plaintiff says the failure of the Legislature to use this method, and instead providing a tax on the rental use of property which had not been subjected to sales or use tax on its purchase, caused uncertainty, confusion, conflict and vagueness which would render the rental tax enactment unconstitutional. Sec. 144.010 is a definition section while Sec. 144.020 is the section that imposes the tax. We see no good reason why the tax could not be imposed by amending Sec. 144.020 to tax these transactions as a rental service charge without defining it as a sale at retail. In the 1962 IBM case, we did not say that defining such rental service as a sale at retail was the only way to impose a valid tax on it. We said (362 S.W.2d l.c. 639): 'By carefully defining 'sale at retail' and purposefully embracing in the definition and the tax certain rental-type transactions, it would appear that other rentals and leases were not embraced.' In that case there was then nothing in the tax imposition statute, Sec. 144.020, to impose a tax on such rentals and the only claimed ***837** basis for taxing rentals of IBM machines was that such rentals constituted sales at retail. Thus the basis of that decision was that since several rental-type transactions were included in the definition (in the definition Section 144.010) and rental of business machines were not included, we would not hold such transactions taxable as sales at retail. There is no basis for any doubt that Sec. 144.020, subd. 1(8) specifically makes these rental transactions taxable.

In view of our ruling that plaintiff has no use tax liability in bringing into this state for rental purposes the machines it manufactures, it is not necessary to consider its contention that certain regulations and rules of the Department of Revenue authorize an optional tax. Plaintiff says these authorized a purchaser of tangible personal property to be rented to pay the sales tax on the purchase price and have no liability for sales tax on rentals or to pay no sales tax on the purchase price and be liable to collect sales tax on the rentals. Plaintiff says this would violate Secs. 1 and 2, Art. X of the Missouri Constitution. Defendants say this option theory is not being followed but there is nothing in the record about it. This all goes to plaintiff's claim that Sec. 144.020, subd. 1(8) is so vague, confusing and inconsistent with the provisions of the sales and use tax laws as to constitute a violation of the constitutional provisions of equal protection and due process. Our ruling as to the meaning and application of the use tax provisions and the validity of the amendment to Sec. 114.020 disposes of these contentions.

[7] Plaintiff also claims the title of the 1963 act amending Sec. 144.020 was constitutionally defective because it did not adequately describe the content of the part of the bill which became Section 144.020, subd. 1(8). The title to this act was: 'An Act to repeal section 144.020, RSMo 1959 and sections 144.140, 144.285 and 144.440, RSMo 1961 Supp., relating to sales and use tax and to enact in lieu thereof five new sections, relating to the same subject, with a severability clause.' Laws 1963, p. 195. The requirement of Sec. 23, Art. III of the Constitution is that '(n)o bill shall contain more than one subject which shall be clearly expressed in its title'. Plaintiff says: 'The purpose of the constitutional provision that the subject matter of all bills shall appear in the title, is to permit the legislators to determine by examining the title of a proposed act, what its purpose is, so that proper consideration may be given it,' citing State ex rel. United Railways Co. v. Wiethaupt, 231 Mo. 449, 133 S.W. 329; State ex rel. Niedermeyer v. Hackmann, 292 Mo. 27, 237 S.W. 742; State ex rel. Normandy School District of St. Louis County v. Small, Mo.Sup., 356 S.W.2d 864. Plaintiff argues that this title does not show that a new service was to be taxed or that there was an exemption from the tax on rental charges when a purchase for rental is made under conditions of sale at retail. However, the title did show what sections relating to sales and use tax were to be repealed (including 144.020) and that new sections relating to the same subject were to be enacted. Sec. 144.020 already included sales tax on several kinds of service or rental transactions and the amendment only added another so that the amendment did relate to the same subject. It does not seem reasonable to believe that members of the Legislature or others interested would be misled as to the subject matter of this amending act. Sec. 144.020 previously has been amended by acts using the same form of title. See Laws 1947, V. 1, p. 546; Laws 1945, p. 1865. Plaintiff cites the title to the 1935 act (Laws 1935, p. 411) and the 1937 act (Laws 1937, p. 552) but these were complete new acts. Our conclusion is that the title was sufficient.

The judgment is affirmed.

All concur.

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Appendix A-4

Administrative Hearing Commission
State of Missouri

***1** MORTON BUILDINGS, INC., PETITIONER
v.
DIRECTOR OF REVENUE, STATE OF MISSOURI, RESPONDENT
Case No. 88-001879RZ
December 8, 1989

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Statement of the Case

Morton Buildings, Inc., Petitioner, filed a complaint on November 22, 1988, seeking this Commission's hearing and determination on a decision issued October 24, 1988, by the Director of Revenue, Respondent. Petitioner argues that it is entitled to a refund of use taxes paid on raw materials used in another state to manufacture goods which are eventually assembled into a building in this state. Alternatively, Morton Buildings asserts that it is entitled to a credit against such use taxes for taxes paid in other states.

This Commission convened a hearing on the complaint on July 27, 1989. Dale C. Doerhoff, attorney at law with Cook, Vetter & Doerhoff of Jefferson City, and Abraham M. Stanger, attorney at law with Seyfarth, Shaw, Fairweather, & Geraldson of New York, New York, represented Petitioner. Ronald C. Clements, attorney at law and Respondent's senior counsel, represented Respondent.

Pursuant to § 536.080.1, RSMo 1986, this Commission granted the parties' request to submit written arguments. The last brief was filed on November 17, 1989.

Findings of Fact

1. Petitioner, Morton Buildings, Inc., is an Illinois corporation engaged in the manufacture, sale and installation of prefabricated timber-framed, metal- sheathed, utility buildings for use by farm and industry. Morton Buildings has its principal offices in Morton, Illinois, and is licensed to do business in the State of Missouri. It has fifty employees in Missouri.

2. Salaried employees of Morton Buildings make sales of the buildings. There are no sales of Morton Buildings' buildings by lumber yards or other retailers.

3. Morton Buildings' salesmen solicit orders in Missouri from five sales offices. The offices are located in the cities of Mexico, Charleston, Clinton, Chillicothe and Monett. Morton Buildings does not maintain or operate any manufacturing plants in the State of Missouri.

4. After the salesman obtains a written order from a customer, he sends the order to the office in Morton, Illinois for review and final approval. If the customer purchases the building on credit, Morton Buildings evaluates the credit worthiness of the customer. If the home office grants approval, it sends the purchase order to the estimating department, which prepares a bill of materials. A computer system in the estimating department itemizes the materials that are to be used to manufacture the building.

5. Raw materials consumed in manufacturing the building components come from various locations around the United States. For example, lumber purchases are made from the west coast, steel purchases are made from the eastern United States. No raw materials are purchased from Missouri sources.

6. Morton Buildings purchases raw materials in bulk and stores them in its warehouses at various locations, none of which are in the State of Missouri. Morton Buildings purchases no raw materials for application to any particular contract, either in or outside the State of Missouri. Morton Buildings manufactures building components for Missouri customers primarily at Morton Buildings' own factories in Illinois and Kansas. Morton Buildings manufactures a few building components at its Iowa factory.

***2** 7. To manufacture the steel panels that are a component of the buildings, Morton Buildings purchases spools of cold-rolled steel. It sends the rolls to an independent contractor out side of Missouri for application of coatings. It ships the rolls, with applied coatings, to and stores them at one of five manufacturing sites located outside the State of Missouri. When a manufacturing site receives an order and a bill of materials from the estimating department, it manufactures the exterior metal panels from the rolled steel by processing the steel through a machine which rolls channels into the steel, to add strength, and cuts the steel to specific lengths required by the particular order.

8. Morton Buildings manufactures roof trusses at its own manufacturing plants, all of which are located outside of the State of Missouri. Upon receipt of an order, a manufacturing plant will manufacture the trusses by withdrawing lumber from the inventory and cutting it to fit. The wooden members of the truss are fastened with steel truss plates. Morton Buildings manufactures the truss plates from steel rolls purchased in bulk.

9. Morton Buildings manufactures outside of the State of Missouri laminated posts which support the buildings. When a factory receives a specific order, it uses lumber that was purchased in bulk to fabricate laminated posts of the dimensions required by the particular order. The lamination process includes fabrication machines, gluing and nailing. Morton Buildings custom cuts and notches wooden purlins, to which the roofing panels are nailed, and wooden nailers, to which the wall panels are attached, at the manufacturing plant.

10. Morton Buildings manufactures hardware for the buildings at its plant at Goodfield, Illinois. Morton Buildings uses a variety of metal working machines to fabricate the hardware components needed for the buildings. In a few cases Morton Buildings may purchase windows and doors from suppliers. Where Morton Buildings makes such purchases outside of the State of Missouri, it pays use tax on

them. When Morton Buildings makes such purchases in the State of Missouri, it pays sales tax on the purchases. Morton Buildings does not seek a refund of any of those taxes paid.

11. The manufactured components of a particular building are then shipped by truck to the building site on the customer's property.

12. Morton Buildings' employees assemble the building. In a typical project, the crew will unload the manufactured components, dig the holes for the posts which support the building, install the trusses, install the metal walls and metal roofing panels and finish the building with installation of hardware, windows and doors.

13. Morton Buildings sells its buildings for a lump sum price. Generally, the building is a "turnkey" product that Morton Buildings turns over to the customer in a finished condition at the price specified in the initial purchase agreement. The typical farm storage building sold to a Missouri customer takes only four to five days to assemble, from the time the truck arrives at the site until the project is complete and Morton Buildings turns over the building to the purchaser. Morton Buildings bears the risk of loss for any damage to the materials prior to that time. The agreement between Morton buildings and the purchaser is that title does not pass until the building is turned over to the purchaser.

***3** 14. Upon completion, the buildings are affixed to the ground.

15. Morton Buildings performs no other activities in Missouri other than solicitations of sales by its salesmen and assembly of manufactured building components on the customer's site.

16. For the period May 1, 1985, through December 31, 1987, Morton Buildings paid $334,785.06 in use taxes to the State of Missouri. Morton Buildings paid these taxes on the components, computed on the cost of raw materials and labor in manufacturing such components for the buildings assembled in Missouri during that period.

17. Morton Buildings made application for a refund for the period May 1, 1985, through December 31, 1987, by filing its application for usetax refund on DOR Form 472B. The application was under oath, and included not only an application for refund of all the use tax but, in the alternative, credit for use taxes paid or assessed in the states of Iowa and Kansas. Morton Buildings has paid taxes to the State of Iowa on the components manufactured in Iowa. Morton Buildings has been assessed by, but has not yet paid to, the State of Kansas for tax for components manufactured in Kansas. The matter of the Kansas use tax is pending before the Kansas Department of Revenue.

18. On October 24, 1988, the Director denied the application for refund.

Conclusions of Law

Petitioner has the burden of proof in this case. Section 621.050.2, RSMo 1986.

The facts set forth above are not disputed. Morton Buildings claims that the Director of Revenue owes it a refund in the amount set forth in finding of fact 16. The dispositive issue is whether Morton Buildings owes use tax on its use of raw materials it purchased outside of Missouri, manufactured into building components outside of Missouri, and assembled into a building to which title then passes to the purchaser in Missouri. Originally, Morton Buildings paid the use tax on the assumption that, when it assembled buildings in this state using components which it had manufactured outside Missouri, it was liable for use tax on the raw materials from which it manufactured the component building parts.

The Director argues that the raw materials became part of the real estate when the building is erected and before title passes, that Morton Buildings, as the contractor, consumes the raw materials here in Missouri, and that Morton Buildings must pay a use tax. The Director argues that the only completed product is the assembled building and the raw materials are its only components. The Director denies that any significance should be given to the manufacturing processes which occur in Morton Buildings' plants outside Missouri by which the component parts are produced. He claims that this is an "integrated system in which the final completed building is produced from the raw materials.... Those raw materials used to produce the finished building were purchased by Petitioner out of state and brought into Missouri to complete the building." Pages 9 and 10 of the Director's proposed conclusions of law.

***4** In support of his theory, the Director cites § 144.610, RSMo 1986, which provides in part:

> 1. A tax is imposed for the privilege of storing, using or consuming within this state any article of tangible personal property purchased on or after the effective date of sections 144.600 to 144.745 in an amount equivalent to the percentage imposed on the sales price in the sales tax law in section 144.020. This tax does not apply with respect to the storage, use or consumption of any article of tangible personal property purchased, produced or manufactured outside this state until the transportation of the article has finally come to rest within this state or until this article has become commingled with the general mass of property of this state.
>
> 2. Every person storing, using or consuming in this state tangible personal property purchased from a vendor is liable for the tax imposed by this law.

Taxing statutes are to be strictly construed in favor of the taxpayer and against the taxing authority. St. Louis Country Club v. Administrative Hearing Commission of Missouri, 657 S.W.2d 614, 617 (Mo. banc 1983); Brown Group, Inc. v. Administrative Hearing Commission, 649 S.W.2d 874, 881 (Mo. banc 1983); Blue Springs Bowl v. Spradling, 551 S.W.2d 596, 599 (Mo. banc 1977). The plain language of subsection 1 of this section states that the tax is imposed on the use of "any article of tangible personal property purchased." Subsection 2 reinforces the idea by stating specifically that liability is upon "[e]very person ... using ... tangible personal property in this state purchased...." To be subject to use tax, the items in question (1) mustbe articles of tangible personal property, (2) must have been purchased and then (3) stored, used or consumed within Missouri. Morton Buildings did not purchase the manufactured components it used in this state. It made them itself. The use of these items

is therefore not taxable, and Morton Buildings is not liable for any tax. See also, 12 CSR 10-4.075, the Director's use tax regulation for contractors which is addressed only to purchases.

This conclusion is required by the holding in International Business Machines v. David, 408 S.W.2d 833 (Mo. banc 1966). In that case, the Director, in defending himself against a claim that the sales tax on IBM's computer rentals was discriminatory, took the position that IBM was not liable for use tax on the raw materials which it used outside Missouri to produce the computers which it then brought to Missouri to rent to its customers. The court agreed:

> From all of these provisions, our view is that our use tax applies to the completed article (machine here) that is brought into this state and not the items of raw material that went into its manufacture, which, of course, are greatly changed in form and could not be identified as separate articles. Because the machines involved herein were not purchased by plaintiff [IBM], but manufactured by it, they are not subject to our use tax. Likewise, because the raw material used to make these machines was never used in this state as such, it seems reasonable to hold there is no basis for a use tax on its value because it is part of a machine which is the article used in this state.

***5** 408 S.W.2d 833, 836 (emphasis in original).

Applying this holding to our case, Morton Buildings is not liable for use tax on its raw materials used to manufacture the building components because the manufacturing process changes them to the extent that they cannot be identified as "articles" to which use tax can be applied. Furthermore, the component parts which are used in Missouri to assemble the building are not subject to use tax because Morton Buildings never purchased them.

This Commission rejects the Director's attempt to characterize the components parts as still being "raw material." The Missouri Supreme Court defined manufacturing as "a transformation of a raw material by the use of machinery, labor and skill into a product for sale which has an intrinsic and merchantable value in a form suitable for new uses." Jackson Excavating Company v. Administrative Hearing Commission, 646 S.W.2d 48, 51 (Mo. banc 1983). "That the process involves a raw material already suitable for common use is of no consequence." Id. at 51. Although the lumber, steel sheeting, nails and other raw materials that go into the building components manufactured by Morton Buildings outside Missouri may be suitable for common use before they are made a part of the building components, these raw materials nevertheless lose their individual identities and become part of a manufactured product.

Because we have determined that no tax was due on the use of the manufactured components, Morton Buildings' claim for a credit against such tax, for taxes paid to other states, is moot.

Summary

This Commission, therefore, decides that no use tax is due upon Morton Buildings' use of the raw

materials or the manufactured components. The Director should refund $334,785.06 to Morton Buildings.

SO ENTERED on December 8, 1989.

PAUL R. OTTO

Commissioner

1989 WL 153531 (Mo.Admin.Hrg.Com.)

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